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**Before the**
**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, D.C. 20554**

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| In the Matter of | ) | |
| | ) | |
| Promotion of Competitive Networks | ) | WT Docket No. 99-217 |
| In Local Telecommunications Markets | ) | |
| | ) | |
| Wireless Communications Association | ) | |
| International, Inc. Petition for Rulemaking | ) | |
| to Amend Section 1.4000 of the | ) | |
| Commission's Rules to Preempt | ) | |
| Restrictions on Subscriber Premises | ) | |
| Reception of Transmission Antennas | ) | |
| Designed to Provide Fixed Wireless | ) | |
| Services | ) | |
| | ) | |
| Cellular Telecommunications Industry | ) | |
| Association Petition for Rule Making and | ) | |
| Amendment of the Commission's Rules | ) | |
| to Preempt State and Local Imposition | ) | |
| of Discriminatory and/or Excessive Taxes | ) | |
| and Assessments | ) | |
| | ) | |
| Implementation of the Local Competition | ) | CC Docket No. 96-98 |
| Provisions in the Telecommunications Act | ) | |
| of 1996 | ) | |



**COMMENTS OF UNITED STATES COMMUNICATIONS ASSOCIATION IN RESPONSE TO NOTICE OF INQUIRY ON STATE AND LOCAL TAXES**

The United States Communications Association ("USCA") submits the attached white paper entitled "Tax Policies to Support the Information Highway: A Framework for State and Local Taxation of Telecommunications and Information Services" in response to the Commission's notice of inquiry on state and local taxes in this proceeding.

The USCA is an organization that provides a forum for interexchange of ideas regarding

federal, state, and local taxation of communications companies throughout the United States. Its membership consists of local exchange carriers, interexchange carriers, wireless communication carriers, cable companies and others that have an interest in communications taxation. In the past, USCA has participated in several discussions to formulate tax policy with the Internal Revenue Service, served on the NTA/Communications and Electronic Commerce Tax Committee, and participated in the recent Committee on State Taxation (COST) study, the results of which were presented to the federally-mandated Advisory Commission on Electronic Commerce.

The USCA endorses the tenets set forth in the attached white paper, which was prepared with the input of many of its members to serve as a tool for federal, state, and local legislators to help them make informed decisions about taxation of communications services in their respective jurisdictions. It recognizes the inequities and inefficiencies in taxation both between competing communications companies and between communication companies and the rest of the business community.

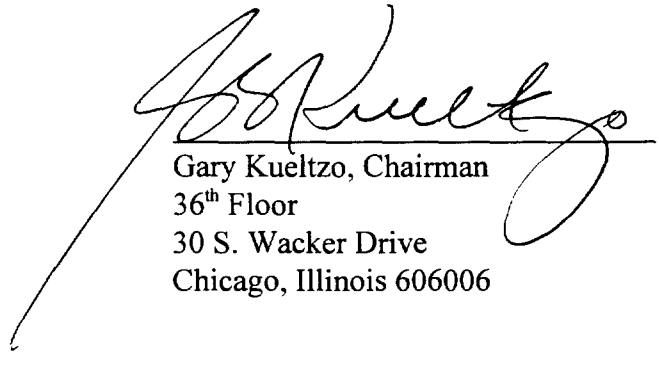
As the white paper points out, state, and local tax systems applicable to some participants in the telecommunications industry were designed during an era when telecommunications services were provided by an extensively regulated, nationwide monopoly. Telecommunications companies in some states continue to be subjected to state and local taxes and fees that were justified historically as a *quid pro quo* for special rights and privileges the states and localities granted to utilities, such as a regulated monopoly franchise. Some of the existing state and local tax systems applicable to the telecommunications industry result in substantial tax discrimination

between equivalent taxpayers, services, and property.

As the report points out, tax regimes should be corrected to comply with general principles of economic neutrality and equity. In other words, taxpayers that provide services on the information highway should not be subjected to excise, property, or income taxes different from those that are imposed on other taxpayers. Functionally equivalent transactions involving the information highway, as well as functionally equivalent property employed in connection with the highway, should receive comparable tax treatment. Finally, taxes should be easy to administer and collect.

Respectfully submitted,

UNITED STATES COMMUNICATIONS ASCOCIATION



Gary Kueltzo, Chairman
36th Floor
30 S. Wacker Drive
Chicago, Illinois 606006

Dated: October 12, 1999

# TAX POLICIES TO SUPPORT THE INFORMATION HIGHWAY: A FRAMEWORK FOR STATE & LOCAL TAXATION OF TELECOMMUNICATIONS AND INFORMATION SERVICES

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## INTRODUCTION

This document proposes changes to increase the equity, efficiency and administrability of state and local taxes applicable to the telecommunications[1] and information services industries. These industries are currently among the most highly taxed industries in the nation. State and local jurisdictions subject the services provided by the telecommunications and information services industries to a multitude of taxes and fees (such as sales taxes, gross receipts taxes, franchise fees, 911 taxes, telephone relay system taxes, universal service fund fees and regulatory fees) that are not imposed on services provided by

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[1] Throughout this report we use the term "telecommunications" in its broadest sense to include services provided by traditional telephone companies, interexchange carriers, wireless telecommunications providers (including cellular, PCN and satellite services) and cable television services (including direct broadcast satellite services).

other industries. There are also significant differences in how comparable services are taxed from sub-group to sub-group within these industries. Moreover, substantial administrative burdens exist in complying with the taxes imposed by state and local governments on these industries and there exists a substantial risk of multiple taxation as these industries merge into the information highway. In the property tax area, there are additional differences that discriminate against these industries when compared to the general business taxpayer.

The proposals in this document are inspired by the dramatic technological and structural changes that are currently reshaping these industries - changes that are creating what is popularly referred to as the "information highway." These changes have captured the attention of the Administration and Congress which, in response, have undertaken a wide-ranging examination of the issues bearing on the development of the information highway. They have captured the attention of the business community, which has been engaged in a steady stream of mergers, acquisitions, joint ventures and associations designed to deliver the next generation of telecommunications and information services. The changes have also captured the imagination of the public, resulting from an outpouring of media coverage directed at the enormous impact that the growth of the information highway will have on our daily lives.

The particular concerns of this document are the surprisingly profound state and local tax implications associated with the current and future development of the information highway. Effective and equitable taxation of the information highway requires a thorough understanding of the complex technology involved and the states' and localities' present efforts to tax the information highway. Unfortunately, existing state and local tax systems often deal inadequately or not at all with the host of novel issues raised by the new technological and commercial environment in which the telecommunications and information services industries are operating and will continue to operate. Moreover, the assumptions on which the existing state and local tax systems were constructed create distinctions in the tax treatment of activities and property that no longer correspond to any underlying functional or economic distinction between the activities and property in question.

This document identifies the problems created by state and local taxation of the information highway and suggests solutions consistent with both federal policy objectives, sound principles of tax policy and the experience of the telecommunications industry in administering state and local taxes.

## GUIDING PRINCIPLES FOR REVISING STATE AND LOCAL TAXES APPLICABLE TO THE INFORMATION HIGHWAY

### INTRODUCTION

## A. INTRODUCTION

We begin our analysis by reviewing the broad federal policies and principles concerning the information highway as expressed by the Administration in The National Information Infrastructure: Agenda for Action.[2] Next we review general principles that should guide policy makers and lawmakers in developing the state and local tax systems that will apply to the information highway. If state and local taxation of the information highway meets no other objectives, it should at least be consistent with and supportive of these policies and principles.

## B. FEDERAL POLICY TOWARDS THE INFORMATION HIGHWAY

Both the Congress and the Administration have undertaken wide-ranging examinations of the issues relevant to the timely development and growth of the information highway. Congress is considering changes to the 1933 Federal Communications Act, and the Administration, in issuing its Agenda for Action, has identified principles and objectives that, in its judgment, should guide the Administration's information highway initiative. Those principles are:

> - Promotion of private-sector investment through tax and regulatory policies that encourage innovation and promote long-term investment as

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[2] Information Infrastructure Task Force, The National Information Infrastructure: Agenda for Action (1993)

well as wise procurement of services.

- Extension of the "universal service" concept to ensure that information resources are available to all at affordable prices.

- Action as a catalyst to promote technological innovation and new applications.

- Promotion of a seamless, interactive, user-driven operation of the information highway.

- Ensuring of information security and network reliability.

- Improvement of management of the radio frequency spectrum.

- Protection of intellectual property rights.

- Coordination with other levels of government and with other nations.

- Provision of access to government information and improvement of government procurement.[3]

Some of these objectives plainly have a more direct bearing on the principles that ought to guide state and local taxation of the information highway than do others. The one explicit reference to tax policy - namely, the objective of promoting private-sector investment through tax policies that encourage innovation, long-term investment, and the wise procurement of services - suggests, at a minimum, that state and local tax legislation should not be hostile to development of the information highway. Taxes applying only to transactions on the

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[3] Id., See Pages 7-12.

information highway, only to revenues earned by providers of services on the highway or only to property of companies on the highway would fail this test.

From an affirmative standpoint, tax policies intended to encourage innovation, investment, and a wise procurement of services should include taxes, tax credits, and tax exemptions for taxpayers serving the information highway at least as favorable as the taxes, tax credits, and tax exemptions for general taxpayers. The Administration recognized that "[i]t is crucial that all government bodies---particularly Congress, the FCC, the Administration, and state and local governments---work cooperatively to forge regulatory principles that will promote deployment of the [information highway]".[4] An analogous point can be made with respect to state and local taxation. The lack of uniformity among states and localities in the manner in which they treat identical transactions, not to mention the lack of uniformity within a single state in how it treats functionally equivalent transactions, is the biggest obstacle created by the state and local tax structure impeding the development of the information highway. The adoption of a uniform approach to state and local taxation of transactions occurring both on and off the information highway would go a long way towards eliminating

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[4] Id., at page 11.

artificial roadblocks to the creation of a "seamless, interactive, user-driven operation."[5]

## C. PRINCIPLES OF SOUND TAX POLICY

Beyond the broad objectives advanced by the Administration for promoting investment in and operation of the information highway and the activities of the Congress, well-established principles of tax policy provide further guidance regarding the appropriate form of state and local taxes affecting the information highway. Those principles are economic neutrality and equity, ease of administration, no multiple taxation and revenue neutrality.[6]

### 1. Economic Neutrality and Equity

Widely accepted criteria of sound tax policy are that a tax should be economically neutral as well as equitable. A tax is neutral (or efficient) when it does not induce taxpayers to

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[5] Id., at page 9.

[6] An executive briefing document, distributed by the office of Governor Christine Todd Whitman in connection with her 1995 Budget Address to the New Jersey Legislature, cited a similar list of tax principles upon which the Governor based her 1995 state budget. For a general discussion of the principles of tax neutrality, equity and administrability as they affect the telecommunications industry, see Karl E. Case, State and Local Tax Policy and the Telecommunications Industry (Council of Governors' Policy Advisors) (1992).

change their behavior in response to the tax.[7] A broad-based profits tax, for example, is generally regarded as neutral because a firm will make the same profit-maximizing decisions it would have made in the absence of the tax. In contrast, a tax narrowly focused on one segment of industry is not neutral because it will induce taxpayers to make choices that they would not have made without the tax - presumably to shift their spending or investment away from the taxed activities, goods, or services towards non-taxed activities, goods, or services that have now become relatively more attractive in terms of their after-tax price.

A tax is equitable if the tax burden is distributed fairly. The central concept of equity is equality of tax treatment among similarly situated taxpayers. Thus, a tax narrowly focused on one segment of industry or on certain providers within that segment would not be equitable. Functionally equivalent taxpayers, services and property should be taxed comparably.

The principles of tax neutrality and equity are important for many of the issues that arise with respect to state

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[7] Some taxes are designed not to be neutral, but to encourage certain behaviors. For example, the investment tax credit was designed to spur investment. Taxes on alcohol and tobacco products are sometimes designed to discourage the use of these products.

and local taxation of the information highway. For example, businesses who provide services over the information highway ("on-highway") and their customers should not be subjected to different taxes from those that are imposed on businesses who provide competing services off the information highway ("off-highway") and their customers or from those imposed on the general business taxpayer. Subjecting on-highway providers but not off-highway providers or the general business taxpayer to tax is not only inequitable, it will distort economic decision making by increasing the cost of doing business on-highway and by inducing businesses and customers to redirect their efforts to off-highway activities. Similarly, the concept of equality insures a "fair" tax system wherein a "level playing field" is created so that taxpayers offering equivalent services and products are accorded equivalent tax treatment. If the tax laws treat functionally identical transactions or property differently merely because the taxpayer is deemed to be a "telephone company," for example, the inescapable impact is to favor unfairly those taxpayers who engage in such transactions or own such property but who can escape the formal denomination as a "telephone company."

Tax neutrality and equity require that functionally equivalent transactions occurring on-highway, as well as functionally equivalent property employed in connection with the

information highway, should receive comparable tax treatment for all providers on-highway, and with that treatment given functionally equivalent off-highway transactions and property. This means that businesses who provide services on-highway and their customers should not be subjected to different excise, property or income taxes than those that are imposed on businesses providing competing services and products off-highway and their customers.

In addition, the tax system should assign the tax base to the jurisdiction with a legitimate claim to that tax base rather than arbitrarily assigning the receipts, income, or property in question on the basis of considerations that are unrelated to the economic activity involved.

**2. Administrability**

Taxes should be easy to administer and collect. No matter how perfectly a taxing system may comport with other requirements of tax policy, if a tax is difficult to understand, if compliance burdens are excessive, and if the costs of administering the tax are unreasonable, the tax will fail to serve its basic intended function as an effective raiser of revenue.

In the context of state and local taxation of the information highway, there are a number of features of the existing state and local tax structure that add to the burden of

administration and compliance and the elimination of these features would greatly ease that burden. For example, artificial distinctions between providers of similar services and unnecessarily vague definitions of the services themselves add needless controversy and complexity to state and local taxation of telecommunications and related services, make it difficult for taxpayers to know whether or not the tax applies and give great leeway to auditors in assessing tax on disputed transactions.[8] The patchwork of specialized excise, gross receipts, franchise, miscellaneous fees and taxes[9] and limited sales and use taxes that characterize the existing system create administrative and compliance costs that unnecessarily burden the information highway.

In terms of administering a tax, perhaps no issue is larger for the service provider than the question of determining the location of the service for tax purposes and collecting a tax on behalf of the government body imposing the tax. For example, an out of state information (i.e., content) provider may transmit information over the information highway to a customer who dials the provider's "900" number. The customer pays for the

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[8] See note 17, infra.

[9] This would include such things as regulatory or PUC fees, surcharges or taxes imposed to fund 911 services, telephone relay systems (TRS or TDD) and telephone assistance, lifeline or universal service plans. See Section F.3., infra.

information (as well as the telecommunication service) with a credit card from a bank located in yet another out of state location. How can a tax on the information be structured to insure that the right party is collecting the tax (the party that is selling the information to the customer, not the transmission company), the tax is easy to administer and the tax assigns to the states in which the services are consumed or performed their appropriate share of the tax base? For present purposes, the point is simply that a workable taxing system must ensure that the taxes imposed are collectible at a reasonable level of administrative and compliance costs.

3. **No Multiple Taxation**

Jurisdictions that tax transactions, income, and property relating to the information highway should not subject these transactions, income or property to multiple taxation. This principle can be viewed as a logical corollary of the principles of tax neutrality and tax equity. If on-highway transactions, income, or property are taxed more than once, whereas off-highway transactions, income or property are taxed only once, the off-highway transactions will be accorded a competitive advantage not accorded to on-highway transactions, with the attendant diversion of resources now driven by tax considerations. The resulting disparity in tax treatment simply will be inequitable.

The principle that transactions, income, or property related to the information highway should not be subject to multiple taxation deserves separate mention because, unless vigilant attention is paid to this principle, there is a high risk that multiple taxation will occur, either intentionally or unintentionally. In the absence of established situs rules (as exist for the sale of tangible personal property) and without the treatment of competing telecommunications services as discrete taxable services, the possibility of multiple taxation by different jurisdictions that seek to tax these rapidly evolving services is self-evident.

Moreover, in a related vein, the multiplicity of taxes on telecommunications services gives rise to repeated instances of a tax imposed on a tax base that includes other taxes. Such "tax on tax" is often unintended but places great compliance burdens on the industry. This "pyramiding" effect of including one tax in the tax base of another tax clearly violates the principle of no multiple taxation.

**4. Revenue Neutrality**

We are well aware that the proposals advanced in this report could have adverse fiscal consequences. Some of the proposals may have significant fiscal impacts among and between

states and localities.

In light of the legitimate concerns that states and localities, on the one hand, and the business community, on the other, might have about the revenue consequences of our recommendations, we wish to make it clear that our proposals are not motivated by a desire either to increase or to decrease state and local revenues. The states should take responsibility for insuring a fair allocation among and between states and local jurisdictions. In any event, we hope that questions of revenue effect will not obscure the principles that we have addressed.

## PROPOSED STATUTORY STRUCTURE

### A. INTRODUCTION

Our notions of the statutory structure that ought to govern state taxation of the information highway have been shaped by the guiding policy principles described in the preceding section.

The practical problems created by the existing framework of state and local taxation strongly reinforce the conclusions dictated by considerations of policy. Indeed, if there is one conclusion that clearly emerges from any consideration of state and local taxation, it is that the different tax treatment of comparable service providers has become increasingly discriminatory as the lines state

legislatures have drawn between formerly separate categories of taxpayers, transactions, and property have faded or disappeared. The technical and operating distinctions that once separated industry groups serving the information highway are rapidly and inexorably disappearing and the failure of states and localities to accommodate their taxing systems to this new reality will only aggravate the problems that we have identified above.

General information highway policy, as envisioned by the Administration, Congress and the information highway participants, suggests a hospitable tax environment for the information highway or, at the very least, a tax environment that does not impede development of the highway. Sound tax policy demands that state and local tax systems be neutral, equitable, administrable and that multiple taxation be avoided. While these policy objectives play out in different ways depending on the particular type of tax we are addressing, there is one overriding theme that guides most of our specific suggestions below and which, if fully embraced by policy makers and legislators, would go a long way towards solving many of the problems we have identified. This theme is equality: equality among businesses that serve or utilize the information highway; equality between these businesses and other businesses; equality between functionally equivalent transactions that occur on-highway and off-highway; and, equality between similar property whether

employed on-highway or off-highway.

**B. SALES AND USE TAXES**

Telecommunications services represent one of the very few services that are pervasively taxed by state and local jurisdictions throughout the United States.[10] The rapidly advancing technology associated with the information highway insures that there will be new issues facing the industry and taxing jurisdictions. There are a number of concrete steps that could be taken in order to assure equality in the sales and use taxation of information highway providers and their customers and to advance the broad federal policy objectives previously identified. The steps we recommend are: 1) separating transmission-based services from content-based services; 2) treating content-related services consistently regardless of how the service is delivered to the customer; 3) clarifying certain tax exemptions, such as the sale for resale exemption; 4) revising the definitional scope of taxable and exempt transactions; 5) addressing nexus and tax collection issues; and,

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[10] The imposition of sales tax on telecommunications services has been a marked exception to the general rule that states sales taxes are limited to sales of tangible personal property. See, Federation of Tax Administrators, Sales Taxation of Services: An Update 2 (1994). Twenty-one states apply the sales tax to intrastate telecommunications services. In recent years, nineteen states have extended the sales tax base to include interstate telecommunications services. And the trend is moving toward the expansion of the sales tax base to an increasing number of services. Id.

6) expanding vendor's compensation to vendors for administering and collecting tax on behalf of the taxing entity.

### 1. Separating Transmission-Based Services from Content-Based Services

Historically, most states have not subjected the provision of information (i.e., content) services at the retail level to sales tax unless the provision of the information services was somehow attached to a sale of tangible personal property (such as the rental or sale of a movie on a video tape).[11] Most sales of information services were simply considered to be sales of intangibles rather than the sale of tangible property. Thus, sales of legal, data processing, accounting, engineering, medical and other services were not considered taxable sales.

In the information highway age, information, entertainment, data and other services, and even tangible goods will be sold over the information highway in a way that formerly was not feasible. Customers will be able to purchase goods and services over the highway on an interactive basis, much as they can today on a face-to-face basis. It is therefore imperative

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[11] In a recent survey, the Federation of Tax Administrators lists 14 states as imposing a tax on "information mainframe services" and 11 states as imposing a tax on "data processing services." FTA, supra, note 10 at 10-11. Other states have sought to apply their sales tax to information data processing and related services even without specific statutory authority. See E. Bialczak, 1320 T.M., Sales and Use Taxes: Information Services (BNA) (1993).

that a clear separation of taxes applicable to transmission services from taxes applicable to content-related services be made by state and local taxing jurisdictions if we are to have an efficient, fair, and workable tax system for taxation of the information highway. Many states and localities currently fail to make this separation.[12]

The distinction between transmission and content is basically that transmission is the transport medium over which the content or message is transmitted. It is essentially a "medium" versus "message" issue. Distinguishing between transmission-based services and content-based services is important for the following reasons.

First, competitive equality between similarly situated taxpayers, and functionally equivalent transactions, can be assured only if the different services are distinguished and taxed or exempted in their own right, not because they are delivered along with another taxable (or exempt) service.

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[12] See, e.g., South Carolina Revenue Ruling #89-14 that the message and transmission are integral and indivisible parts of communication, such that charges for taxable "transmission" services include not only charges for sending a message but also charges for the information (message) itself. The Ohio Tax Commissioner ruled that the charge for information provided over a 900 telephone service, which appears on a caller's telephone bill, was properly subject to sales tax on the theory that any amount which appears on a telephone customer's bill represents a charge for taxable telecommunication services. Opinion of the Tax Commissioner, No. TC 90-0008, Nov. 27, 1990 [1991-1992 Transfer Binder] [Ohio] St. Tax Rptr. (CCH) ¶ 401-004.

Failure to distinguish between transmission and content can lead to competitive inequalities between taxpayers providing similar services merely because of the manner (the "medium") in which the service (the "content" or message) is delivered. For example, generally exempt information services, such as medical, legal, data retrieval or "900" type services, that are provided over communication lines should not be taxed as part of taxable telecommunications services, simply because they are provided over taxable telecommunications lines. The normally non-taxable "content" embodied by these services should not be tainted for tax purposes because the transmission medium, telecommunications, is taxable.

Second, even in those states that tax the relevant universe of both transmission-based and content-based services, the separate identification of the services can be critical to determining who must pay, collect and remit the particular tax, and at what rate. If no effort is made to distinguish the services between content and transmission, the transmitter of the service may be saddled inappropriately with tax billing, collection and payment responsibilities that should legally be the obligation of another taxpayer. This point takes on added importance in light of our view, set forth in Subsection 5 below, that transmission ("medium") companies should never be saddled with tax collection obligations relating to the sale of an

information provider's services ("message/content") merely because those services have been transmitted over the transmission company's facilities.

### 2. Treating Content-Related Services Consistently Regardless of How Delivered

Once transmission-related services have been separated from content-related services, it is necessary to examine how content-related services provided on the information highway should be taxed. It simply is inappropriate to single out providers of services or products that are provided on-highway for special or different tax treatment from those provided off-highway. Equal tax treatment must be established for all content-based services and products whether the services or products are provided off-highway or on-highway. For example, if legal or medical services provided off-highway are not subject to sales taxation, they should similarly not be subject to taxation simply because they are now provided via transmission on-highway. The fact that the services are now provided on-highway should not be an excuse to discriminate against on-highway providers of these otherwise nontaxable services.

### 3. Clarifying Sales Tax Exemptions

Sales taxes are uniformly applied only to final sales of taxable transactions (products). An intermediate "sale for resale" of an item is therefore exempt in order to avoid multiple levels of taxation. But the sale for resale exemptions in most

states are not broad enough to deal adequately with information highway transactions.[13] The sale of information highway services ought to be accorded a sale for resale exemption, at a minimum, that is similar to that provided for sales of tangible personal property or other taxable services. Specifically, a sales tax should apply no more than once to an on-highway transaction. Moreover, no tax should apply to an on-highway service consumed in providing another information highway service or to an on-highway service purchased by one party and incorporated into another on-highway service.

**a. Only Final Sales of Taxable Information Highway Services Should be Taxed**

In order to eliminate multiple taxation of information highway services, states should adopt a more rational approach to the sale for resale of information highway services than is found under the current system. The absence of a systematic and economically sensible approach to the resale issue creates competitive inequalities and arbitrary distinctions between similarly situated taxpayers based on such artificial (and easily

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[13] In order to avoid multiple layers of taxation on tiered transactions, most states expressly provide for statutory sale for resale exemptions of tangible personal property. However, most states do not provide expressly for a statutory sale for resale exemption attributable to services.

manipulable) factors as billing practices and mode of delivery.[14] Moreover, the determination that a service is "consumed" rather than "resold" frequently leads to double taxation and, in turn, unequal treatment of functionally equivalent transactions.[15] For example, in some states that tax

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[14] For example, the Ohio Tax Commissioner concluded that the separately stated telecommunications services purchased by a data processor and rebilled to its customers were taxable as data processing services because the taxpayer "does not provide telecommunications services to its customers; rather it rebills its customers for charges by its long distance carrier." Hence, the Commissioner concluded that "these telecommunications charges are part of the data processing services... and the entire transaction is subject to tax." Opinion of the Tax Commissioner, Ohio Tax Commissioner, No 92-003, Aug. 11 1992, [3 Ohio] St. Tax Rep. (CCH) ¶ 401-383 at 22,495. The South Carolina Tax Commission has likewise ruled that a tax is due on "charges for the ways or means for the transmission of voice or of messages." The ruling was applied to the time-based fee charged to customers by the operator of a database, who obtained access to the database over telephone lines. S.C. Priv. Ltr. Rul. 89-21, S.C. Tax Commissioner, Dec. 12, 1989, [S.C.] St Tax Rep. (CCH) ¶ 200-384.

[15] In some states there is a tendency not to recognize the sale for resale of services exemption. In these states it is reasoned that telecommunications and information services are "consumed" by an intermediate purchaser of such services, and are therefore subject to tax, even though these services will - in economic substance, if not in form - be resold in a subsequent taxable transaction. See e.g., Conn. Dep't Revenue, Ruling 91-16, June 15, 1991, [2 Conn.] St. Tax Rep. (CCH) ¶ 360-416 (company uses telecommunication services in providing computer and data processing services); Future Vision Cable Enter., Inc. v. Taxation Div. Director, 9 N. J. Tax 165 (1987)(cable company's purchase of installation services subsequently sold to its customers as hook-up fee is exempt as resale only if it can specifically identify particular installation service resold to a particular subscriber); Oklahoma Tax Commission, Order No. 89-06-01-21, May 18, 1989 [2 Okla.] St. Rep. (CCH) ¶ 200-539 (company providing "least cost routing" service for long distance calls is consumer, not reseller, of telephone services it purchases).

both telephone service and cable television service, if a telephone company provides video dialtone service to a cable programmer, which the programmer then uses to provide cable television services to end-user customers, the cable programmer will be deemed to be the "consumer" of the video dialtone telephone service, and subjected to sales taxation. In addition, the subsequent sale of this service to the end-user customer will be deemed a taxable sale of cable television service.[16] In this instance there is no recognition of a sale for resale exemption for the video dialtone telephone service since it is deemed not to be used to provide another taxable "telephone" service, but rather a completely different taxable service - cable television service.

To the extent a jurisdiction taxes information highway services, we urge that the sale for resale exemption in the context of the sale of information highway services be designed and construed to assure that only the final sale of a taxable information highway service can be subject to tax. This means that any sale of an information highway service should be exempt

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[16] For example, U S WEST, Inc., has determined on a preliminary basis, that its proposed sale of video dialtone access will be subject to sales tax in Minnesota and the person using the video dialtone to provide video services will be subject to sales tax as a cable operator, resulting in double sales tax.

as a wholesale sale if there is a subsequent transaction to another purchaser, in which the cost of the first service is reflected in the price of the final sale of a taxable information highway service.

We recognize that this recommendation may go beyond the existing understanding of the resale exemption in many states under current law. For example, the final sale generally has to be of a like-kind service (e.g., wholesale telephone to retail telephone) to qualify for the resale exemption. We nevertheless believe that it is essential for the resale exemption to be extended to these "wholesale" sales of services if similar treatment of similarly situated taxpayers and transactions on and off the information highway is to be achieved.

**b. A Manufacturing-Type Exemption Should Be Provided for Information Highway Services That Are Consumed in Providing Other Information Highway Services**

Where an information highway service is utilized or consumed by another information highway provider in providing a second information highway service, the provision of the first service should be granted a manufacturing-type sales tax exemption even if the final sale is not taxable. This would mean that if a telephone service were sold to a cable television company which then consumes the service in order to provide cable television service, the sale of the first service would be exempt even if the sale of cable television service is not subject to

sales taxation. This recognizes the fact that any current distinctions between the various types of information services are rapidly disappearing. Sales tax laws should recognize that it will be virtually impossible to determine where one service begins (e.g., local telephone service, long distance service, wireless service or video service) and the other telecommunications service ends on the information highway.

### 4. Revising the Definition of Taxable and Exempt Transactions

As described in the preceding sections, legislatures and administrators have created significant problems by defining taxable and exempt services in ways that are often vague, sometimes overinclusive, sometimes underinclusive, and often with little or no rational legal or economic basis.[17] Other problems

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[17] Many issues involving state sales and use taxation of telecommunications services concern definitional questions. The taxability of a service may depend on how it is characterized. In many cases services are rather arbitrarily classified: as "telephone service," e.g., New York Cable Television Ass'n v. State Tax Comm'n, 388 N.Y.S. 2d 560 (Sup. Ct., Spec. Term, Albany Cty. 1976), aff'd, 397 N.Y.S.2d 205 (App. Div., 3rd Dep't 1977)(cable television companies not engaged in selling taxable services of "telephony" or "telegraphy" because, while the service involves dissemination by electronic means of communication, and there may be telephonic or telegraphic transmission of a signal incident to the service provided, the essential object of the service is to provide "entertainment or enjoyment"); GTE Telemessenger Inc., State Tax Comm'r, Advisory Opinion, TSB-A-89(45)S, Nov. 20, 1989, 1989-90 Transfer Binder N.Y. St. Tax Rep. (CCH) ¶ 252-842 (voice messaging and answering services constitute taxable "telephone services"); Wisconsin Department of Revenue, Wisconsin Tax Bulletin # 50, April 1987, (1986-1990 Transfer Binder Wis.) St. Tax Rep.(CCH) ¶ 202-857 (voice messaging service does not constitute taxable telephone

stem from similarly unjustifiable distinctions based on classification of sellers or buyers.[18] We see no justification, for example, for taxing sales by "regulated"

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services); as **"communications service,"** e.g. In re Data Transmission Network Corp., Iowa Department of Revenue and Finance, Oct. 5, 1992 [2 Iowa] St. Tax. Rep. (CCH) ¶ 200-700 (sales of information to subscribers by way of electronic information system not taxable "communication" service because it involved only one-way communication); as **"data processing service,"** e.g., First Federal Sav. and Loan Ass'n of Wood County v. Limback, Ohio Board of Tax Appeals, No. 88-R-175, August 16, 1991 [1991-1992 Transfer Binder] [Ohio] St. Tax Rep. (CCH) ¶ 401-024; taxable "automatic data processing" charges do not include a data processing company's terminal interface charges, which represent the company's pass through of nontaxable telecommunications charges for circuits serving the customers; as **"information service,"** e.g., NASDAQ, Inc., State Tax Comm'r, Advisory Opinion, TSB-A-89(31)S, Aug. 29, 1989 [1989-90 Transfer Binder] [N.Y.] St. Tax Rep. (CCH) ¶ 202-547, (private line stock quotation service taxable as information not telephone service); or, as **"private line service,"** e.g., First Federal Sav. and Loan Ass'n of Putnam County v. Department of Revenue, Div. of Admin. Hearings, No. 92-27630, June 6, 1993 [2 Fla.] St. Tax Rep. (CCH) ¶ 202-547. (private line data processing service was exempt as professional service).

[18] When the taxability of a service depends on whether the service provider falls into a defined statutory category (e.g., a "telephone company" or a "public utility"), functionally equivalent services may be taxed differently. Such distinctions undermine the goal of providing a level playing field for the taxation of equivalent telecommunications, cable and information services regardless of who delivers them or the form in which they are delivered. Moreover, in light of the sweeping definitions of "telecommunications," "information," and related service in many of the state statutes, there are a vast number of enterprises which are - unbeknownst perhaps to their own tax managers - subject to these levies. Thus, hotels and motels may be classified as telecommunications service providers. See, e.g., HBE Corp. v. Director of Revenue, Mo. Admin. Hearing Comm'n., Feb. 24, 1992, [2 Mo.] St. Tax Reptr. (CCH) ¶ 201-541]; owners of "smart" buildings may find themselves subject to public utility taxes; and consultants may be saddled with exactions on information services.

companies but not taxing comparable sales by "non-regulated" companies.

Such archaic definitions and distinctions need to be changed to clarify existing laws in light of the changing technological environment as well as to improve the laws through changes such as those we have proposed in this document. The states can and should take steps to eliminate the problems of arbitrariness and competitive inequality that exist under today's systems with the goal of treating all providers of equivalent or comparable services the same without regard to the nature of the entity providing the service. Laws and regulations must provide definitions that make absolutely clear how sales and use taxes apply to information highway transactions and service providers: what transactions and services are taxable, and which providers are responsible for collecting taxes. Providers should not be forced to play the "audit lottery" in meeting their sales tax responsibilities.

**5. Tax Collection Issues**

Finally, with regard to tax collection issues (which are separate from the level-playing field issues addressed above) we have recommendations that bear on the question of the appropriate approach that should be used to collect sales or use taxes on taxable information highway services provided by third-party service providers. States should not be allowed to use

their tax collection mechanism to ignore the legal requirements of nexus or to impose a collection obligation on a party who merely facilitates a transaction via transmission, transport or billing of the information.

For example, states do not require transportation companies, such as Federal Express or United Parcel Service, that are simply facilitating purchases between vendors and purchasers by transporting the goods to the ultimate purchaser to collect sales tax for vendors' (shippers') sales, even if a purchase is on a COD basis. This is because the transportation companies are not the vendors; they simply represent the "medium" facilitating the transaction. Likewise, states do not require credit card companies that facilitate purchases between buyers and sellers to remit sales taxes for amounts billed to the buyer's credit card. Again, this is because the taxpayer is the vendor selling the goods, not the credit card company that facilitates the transaction.

However, a number of states have sought to impose a tax collection burden on telecommunications companies that transmit third-party information service from the information provider to the information provider's local consumer.[19] This is completely

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[19] At least two states have imposed this obligation by statute. New York requires that any person billing upon behalf of a vendor providing entertainment or information services by means of telephone service shall be deemed a vendor of such services liable for the obligation of collecting, reporting and

inappropriate. In many instances, the transmission company will have no information regarding the bill for the information or other service provided by the remote information provider. It might, for example, be billed to a credit card number. Secondly, the local exchange company or interexchange carrier will generally have no knowledge as to the particular service or product being provided or its taxability, and it would be inappropriate for these companies to make arbitrary tax decisions. Incorrect taxing decisions will engender disputes by both information service providers and their customers. Moreover, even if the transmission company in some instances does have this information, saddling the transmission company with the tax collection responsibility is improper because it is not the taxpayer, and certainly will create competitive inequalities between those information services that are billed through telecommunications providers and those that are not.

Consequently, we believe that the only satisfactory solution to this problem is to require that the transmission company has no responsibility or liability for billing,

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remitting applicable sales taxes. N.Y.S. § 1101(b)(8))ii)(B) (McKinney 1994). Minnesota has imposed liability for collecting a tax on services provided by 900 service information providers on the person contracting with the information service provider to interconnect the information provider with its customer ("calling party") or otherwise on the person billing the customer (this would apparently apply to credit card companies as well). Minn. Stat. Ann. § 297A.136, Subd.3 (West 1995).

collecting or remitting state and local taxes that apply to "content" based services or products sold over the information highway by third-party providers. The requirement to bill, collect and remit state and local taxes on these services or products should remain the responsibility of the selling vendor/provider, subject to federal requirements of nexus and due process. The transmission company should not be placed in the position of having to bill, collect or remit taxes simply because the information highway is the medium over which the transaction is facilitated through transmission, transport or billing of the information. Without a law absolutely limiting a state's ability to require the transmission company to bill, collect and remit taxes on third-party transactions, these companies will be placed in the untenable position of being subjected to enormous tax assessments on audit for taxes due or allegedly due with respect to another taxpayer's transactions.

States are already suggesting that because these transactions take place over a transmission company's facilities that some sort of agency relationship is created whereby transmission company has an agent's liability to collect and remit taxes for the principal, i.e., vendor. While this is not true, the fact is that when subjected to a huge jeopardy assessment by the state, the transmission company will be in the unenviable position of having to prove it is not the taxpayer.

This risk of tax assessment for a third-party's tax could do more to stifle the development of the information highway than any other tax issue. A transmission company may feel it is risky to allow content providers to use their transmission facilities where there is the possibility that the transmission company may be liable for the content provider's taxes. For example, let us assume a transmission company sells transport to a content provider for $100 for 100 minutes of transmission time. Assume that a content provider in Los Angeles sells $100,000 of service or product over the highway during those 100 minutes of use. Assume further that the purchasers are all in Seattle, which has a combined sales tax rate of 8.2%. The potential sales tax liability of the transmission company would be $8,200, exclusive of penalties and interest, for a sale that gave the transmission company $100 of gross revenue and maybe $1 of profit. The potential tax liability simply dwarfs the expected income to the transmission company from the transaction. This threat is real. In fact, one of the Regional Bell Operating Companies[20] was recently assessed $1,000,000 in taxes for a third-party information company's tax liability, for which the RBOC generated about $75,000 in transmission and billing and collection revenue. Limiting a transmission company's

[20] U S WEST, Inc., with respect to 900 service tax imposed on third-party companies' 976 and 900 information services.

responsibility and liability is a must if the information highway is to prosper. Accordingly, transmission companies should be given the same protection that now exists for credit card companies, banks, finance companies, Federal Express, common carriers, transportation companies and other firms that simply facilitate third-party transactions.

**6. Expanding Vendor's Compensation for Administering Taxes.**

In addition to the tax collection issues discussed in Subsection 5 above, telecommunications providers are faced with enormous financial costs and administrative burdens in billing, collecting and remitting state and local taxes on behalf of the states. These burdens are far in excess of what most vendors face because of the significant number of services that telecommunications companies provide to customers, many of which have vastly different tax treatment, and the large geographic areas that telecommunications companies cover. Most are at least city-wide, some are county-wide, state-wide, national and even international.

Very few states offer telecommunications companies that collect tax revenues on behalf of the taxing states compensation, generally known as "vendor's compensation," for the costs and burdens relating to their billing, collection and payment responsibilities. Those that do offer vendor's compensation generally cap the fee at a de minimis amount in relation to the

administrative costs of billing, collecting and remitting the taxes.[21] In addition, some states even require the collecting companies to pay over the taxes before they have been received from the companies' customers. It is our recommendation that vendor's compensation fees be universally offered as a means of recompensing the collecting agent companies for the substantial costs and burdens of collecting taxes on behalf of governmental bodies.

### C. INDUSTRY SPECIFIC TAXES - UTILITY GROSS RECEIPTS TAXES

Considerations of tax neutrality and tax equity, reinforced by the nation's policy toward the national information infrastructure, militate in favor of abolishing selective gross receipts taxes that a number of states impose on the telecommunications industry.[22] This is particularly true where

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[21] See, for example, Oklahoma law which allows 2.25% of taxes due, up to $3,300 per reporting period as a vendor's fee. Okla. Stat. Title 68, § 1410.1 (1994).

[22] Many states and localities have created tax systems and enacted levies applicable only to utilities. Thus, the telecommunications industry was subjected to state-wide utility gross receipts taxes and to local franchise fees or related levies as a quid pro quo for the special rights and privileges that states and localities granted to utilities (e.g., power of eminent domain, right to use public rights-of-way). These levies are typically only a part of the tax burden imposed on utilities doing business in the state, and are almost always imposed in addition to the retail sales and use tax on services provided by these industries. E.g., see generally Case, supra note 6. Only 5 states currently impose selective gross receipts taxes on the cable television industry. However, because the cable industry also enjoys special rights granted by local governments, it is often subjected to special local franchise and other special fees